

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

, ID No.

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Refer Reply To:

CC:FIP:02

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Date:

November 1, 2013

Legend

Taxpayer =

Holding =

Leasehold =
Partnership

Fee =
Partnership

Entity =

State A =

State B =

Date 1 =

Property =

Address =

x =

y =

z =

Dear :

This is in response to your letter dated June 24, 2013, regarding whether for purposes of determining Taxpayer's gross income under sections 856(c)(2) and 856(c)(3) of the Internal Revenue Code, Taxpayer's allocable share of certain amounts paid from Leasehold Partnership to Fee Partnership will be disregarded as an item of gross income to the extent of Taxpayer's allocable share of Leasehold Partnership's deductions attributable to those amounts paid to Fee Partnership.

FACTS

Taxpayer is an Entity organized under the laws of State A. Taxpayer will make an election to be treated as a real estate investment trust (REIT) for its first taxable year ending on Date 1. Taxpayer will adopt the calendar year for Federal income tax reporting and will use the accrual method as its overall method of accounting.

Taxpayer was formed to invest in Property located at Address through one or more entities treated as partnerships or disregarded entities for Federal income tax purposes. Taxpayer will acquire an x% interest in Holding. Holding will acquire a y% interest in Fee Partnership and a y% interest in Leasehold Partnership. Both Fee Partnership and Leasehold Partnership are entities organized under the laws of State B. Fee Partnership owns (through wholly owned subsidiaries, each of which is disregarded as an entity separate from Fee Partnership for Federal income tax purposes) the land underlying Property. Leasehold Partnership leases (through wholly owned subsidiaries, each of which is disregarded as an entity separate from Leasehold for Federal income tax purposes) the land underlying Property.

As a result of the ownership percentages, Taxpayer will own indirectly a z% interest in each of Fee Partnership and Leasehold Partnership. Through entities disregarded for Federal income tax purposes, Fee Partnership leases the land to Leasehold Partnership pursuant to a ground lease, which requires payments of fixed rent and real estate taxes (collectively, "Ground Rents"). Through entities disregarded for Federal income tax purposes, Leasehold Partnership leases Property to tenants that are unrelated to Taxpayer.

LAW

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from, among other sources, rents from real property.

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from, among other sources, rents from real property.

Section 856(c)(4)(A) provides that at the close of each quarter of its tax year, at least 75 percent of the value of a REIT's total assets must be represented by real estate assets, cash and cash items (including receivables), and Government securities.

Section 856(c)(5)(J) provides, in relevant part, that to the extent necessary to carry out the purposes of Part II of subchapter M of the Code, the Secretary is authorized to determine, solely for purposes of such part, whether any item of income or gain which does not otherwise qualify under section 856(c)(2) or (3) may be considered as not constituting gross income for purposes of section 856(c)(2) or (3).

Section 856(d)(2)(B)(ii) provides that for purposes of sections 856(c)(2) and (3), the term "rents from real property" does not include any amount received or accrued directly or indirectly from any person if the REIT owns, directly or indirectly, in the case of a person that is not a corporation, an interest of 10 percent or more in the assets or net profits of such person.

Section 856(d)(5) provides that, for purposes of section 856(d), the rules prescribed in section 318(a) apply with certain modifications to determine ownership of the stock, assets, or net profits of any person.

Section 1.856-3(g) of the Income Tax Regulations provides that a REIT that is a partner in a partnership is deemed to own its proportionate share of each of the assets of the partnership and to be entitled to the income of the partnership attributable to that share. For purposes of section 856, the interest of a partner in the partnership's assets is determined in accordance with the partner's capital interest in the partnership. The character of the various assets in the hands of the partnership and items of gross income of the partnership retain the same character in the hands of the partnership for all purposes of section 856.

ANALYSIS

Taxpayer will acquire an $x\%$ partnership interest in Holding, which owns a $y\%$ partnership interest in each of Fee Partnership and Leasehold Partnership. Pursuant to section 1.856-3(g), Taxpayer through Holding, will be allocated $y\%$ of the gross income derived by Leasehold Partnership from the rents paid by unrelated tenants in the Property. Taxpayer, through Holding, will be allocated the same percentage of the gross income derived by Fee Partnership from the rents paid by Leasehold Partnership. Further, Taxpayer, through Holding, will be allocated the same percentage of the deduction attributable to Leasehold Partnership's payment of rents. Because the only source of income for Fee Partnership is the Ground Rents paid by Leasehold Partnership, Taxpayer's allocable share of income from Leasehold Partnership will be

double counted because it is already included in Taxpayer's allocable share of Fee Partnership's gross income for purposes of section 856(c). Thus, pursuant to section 1.856-3(g), Taxpayer would be treated as earning the same gross income twice.

CONCLUSION

Based on the facts and representations submitted by Taxpayer, for purposes of determining Taxpayer's gross income under sections 856(c)(2) and (3), Taxpayer's allocable share of Ground Rents paid from Leasehold Partnership to Fee Partnership will be disregarded as an item of gross income to the extent that those amounts do not exceed Taxpayer's allocable share of Leasehold Partnership's deductions attributable to the Ground Rents paid by Leasehold Partnership to Fee Partnership.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Jonathan D. Silver
Jonathan D. Silver
Assistant to the Branch Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)